REMARKS OF JAMES E. NEWSOME, CHAIRMAN
COMMODITY FUTURES TRADING COMMISSION

CFTC-FERC Technical Conference on
Credit Issues & Potential Solutions in Energy Markets
Washington, DC – February 5, 2003

On behalf of the Commodity Futures Trading Commission, I am pleased to welcome you to this joint conference on potential solutions to credit issues in energy markets. I would like to thank my colleague at the Federal Energy Regulatory Commission, Pat Wood, and his fellow Commissioners for the invitation to co-host this important conference and for extending such a warm welcome to my fellow CFTC Commissioners, Barbara Holum, Walt Lukken, and Sharon Brown-Hruska.

The CFTC's mission is twofold: (1) to foster competitive and financially sound futures markets; and (2) to protect market users and the public from fraud, manipulation, and abusive practices. The CFTC strives to protect the integrity of the commodity futures and options markets in three respects. First is the *economic* integrity of the markets, so that they may operate free from manipulation and serve their important role as risk management mechanisms and as means of price discovery. Second, is the *operational* integrity of our markets so that transactions are executed fairly and proper disclosures are made to customers. And, third but certainly not last, is the *financial* integrity of the markets, so that the insolvency of a single participant does not become a systemic problem. On the front lines in defense against such problems are the futures clearinghouses and the clearing members of the futures exchanges. By serving as a centralized counterparty the clearinghouse serves an invaluable role in mitigating credit risks for market participants.

The CFTC is in the midst of implementing a new regulatory framework for the oversight of futures clearinghouses, pursuant to the Commodity Futures Modernization Act, which became law in December 2000. Among other changes to traditional futures law, the Commodity Exchange Act now permits a derivatives clearing organization to clear both on-exchange and OTC contracts. This important change followed a recommendation by the President's Working Group on Financial Markets – which consists of the Treasury Secretary and the Chairmen of the Fed, SEC, and CFTC – that legislation be considered in the area of clearing systems for OTC derivatives. The PWG noted that the clearing of OTC derivatives had "the potential to reduce counterparty risks … through risk management techniques [such as] mutualizing risks, facilitating offset, and netting." The PWG found that OTC clearing systems could serve "a valuable function in reducing systemic risk by preventing the failure of a single market participant from having a disproportionate effect on the overall market."

I am keenly aware of the challenges facing those who desire to use OTC energy derivatives for their risk management needs, including the challenging issue of counterparty credit risk. Thus, I am very interested in hearing what today's panelists have to say about the potential benefits of – as well as challenges raised by – the clearing of OTC energy derivatives. As part of today's discussion, CFTC staff will provide an overview of how we regulate DCOs and their clearing processes. Jane Kang Thorpe, Director of the Division of Clearing and Intermediary Oversight, will moderate panel discussions on clearing services and providers. I look forward to what is sure to be a productive program.